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No. 92-913

In the Supreme Court of the United States

OCTOBER TERM, 1992

BANCO ESPANOL DE CREDITO, ET AL., PETITIONERS

v.

SECURITY PACIFIC NATIONAL BANK, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether the debt instruments sold by respondents to petitioners were "securit[ies]" within the meaning of Section 2(1) of the Securities Act of 1933, 15 U.S.C. 77b(1).

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This brief is filed in response to the Court's order inviting the Solicitor General to express the views of the United States.

STATEMENT

1. a. In 1985, respondent Security Pacific National Bank initiated a "commercial loan note program," which it operated through its subsidiary, respondent Security Pacific Merchant Bank. Pet. App. 12a (Oakes, C.J., dissenting); C.A. App. 4077-4078.[1] Under the program, Security Pacific made short-term loans to corporate bank-

[1] In April 1992, Security Pacific National Bank was merged into Bank of America. See Br. in Opp. ii. Hereafter, respondents will be referred to collectively as "Security Pacific."

ing customers, which it then sold, in whole or in part, to third parties. Pet. App. 12a (Oakes, C.J., dissenting); C.A. App. 4077-4079; see also *id.* at 535-536. These interests in commercial loans, known as "loan notes" or "loan participations," were unsecured, were (in all but a few cases) sold in denominations of $1 million or more, and had maturities ranging from overnight to one year, with a typical maturity of 30 days. Pet. App. 13a (Oakes, C.J., dissenting); *id.* at 29a-30a. They were sold with recourse to the borrowers only, and without recourse to Security Pacific. *Id.* at 14a (Oakes, C.J., dissenting). Security Pacific received as profit the difference between the interest it paid to the purchasers of the loan notes and the interest it charged to the borrowers. C.A. App. 4080.

Security Pacific sold the loan notes only to institutional and corporate entities, not individuals. Foreign and domestic banks accounted for 47% of the purchasers. Non-bank purchasers included corporations (23%), institutional investors (18%), insurance companies (4%), mutual funds (2%), trust departments (2%), and money managers (4%). Pet. App. 13a (Oakes, C.J., dissenting); C.A. App. 4079, 4139-4140. Entities interested in buying the notes signed a Master Participation Agreement (MPA) before their first purchase. Pet. App. 14a (Oakes, C.J., dissenting); C.A. App. 4082. Under the MPA, Security Pacific agreed to collect loan payments from the borrowers and distribute them, with appropriate interest, to the loan note purchasers. C.A. App. 48-49. It also agreed, upon request, to give purchasers any "publicly available financial statements and documents" in its possession concerning the borrowers. *Id.* at 50.[2] Further, Security Pacific promised to "exercise

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[2] Security Pacific provided petitioners, in advance of their purchases, a list of the hundreds of borrowers in the program, C.A. App. 1845-1850 (including the borrower in this case, Integrated

the same care in the administration and enforcement of any [loan] as if it had retained the entire [loan] for its own account." *Ibid.*

The MPA purported to absolve Security Pacific, however, "for any error in judgment or for any action taken or omitted to be taken by it, except for gross negligence or willful misconduct." C.A. App. 49. The MPA also stated that Security Pacific made no representation about the financial condition of any borrower and assumed no responsibility for the "collectibility" of any loan. *Id.* at 49-50. Moreover, the MPA required purchasers to acknowledge that they had "independently and without reliance upon" Security Pacific made their own credit analysis of the borrower. *Id.* at 50. The MPA further provided that participation would be on a "silent basis," *id.* at 51, meaning that participants were prohibited from identifying themselves as such to the borrowers, see *id.* at 55. Participants were also prohibited from selling their loan notes without Security Pacific's consent. *Id.* at 51.

Security Pacific marketed the loan notes as a "short-term investment alternative" to commercial paper. C.A. App. 54. For example, an informational brochure told potential purchasers that "loan notes yield an average of 15 to 50 basis points more than comparable commercial paper." *Ibid.*

b. Integrated Resources, Inc., a financial services organization and existing customer of Security Pacific, became a borrower in Security Pacific's loan note program in April 1988. C.A. App. 4087. Between April and June 1989, the eleven petitioners—which consist of seven foreign banks, one domestic bank, two corporations, and the trustees of a retirement plan—bought 17 notes reflecting loans by Security Pacific to Integrated totalling

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Resources, Inc.) and the borrowers' Standard & Poors rating. Integrated was rated A2 at the time of petitioners' purchases of Integrated loan notes from Security Pacific. Pet. App. 30a-31a.

approximately $77.5 million. Pet. App. 5a, 29a-30a, 31a; C.A. App. 607-618.

In late 1988, Integrated encountered financial difficulties. In April 1989, Security Pacific refused to increase its internal line of credit to Integrated. Nonetheless, Security Pacific continued to sell participations in Integrated loans. Pet. App. 5a. In June 1989, Integrated began defaulting on its loans and later filed for bankruptcy. *Ibid.*

2. Petitioners filed two actions, consolidated on appeal, seeking, *inter alia*, rescission of their purchases of the Integrated loan notes under Section 12(2) of the Securities Act of 1933 (Securities Act), 15 U.S.C. 77*l*(2). Pet. App. 3a-4a, 26a. They claimed that Security Pacific violated the Securities Act by "misstat[ing] or omitt[ing] to state material facts * * *, including facts concerning Integrated's true financial condition and creditworthiness." C.A. App. 36. On cross-motions for summary judgment, the district court dismissed the actions, holding that it lacked subject matter jurisdiction because the loan notes were not "securit[ies]" within the meaning of Section 2(1) of the Securities Act, 15 U.S.C. 77b(1). Pet. App. 24a-43a.

The court determined that the question whether the loan notes were securities was governed by *Reves* v. *Ernst & Young*, 494 U.S. 56, 65 (1990). Under *Reves*, the district court explained:

> [C]ourts are to start out by presuming that a note is a security, but that presumption may be rebutted by a showing that the note bears a strong resemblance to one of the enumerated categories which the Supreme Court set forth in *Reves* of non-securities, to be tested by four factors: 1) the motivations that would prompt a reasonable seller and buyer to enter into it; 2) the plan of distribution of the instrument; 3) the reasonable expectation of the investing public; 4) existence of some other factor such as another regulatory scheme thereby rendering securities regulations unnecessary.

Pet. App. 35a (citation omitted). Applying *Reves*, the district court concluded that "the short-term loan participations sold by Security Pacific * * * bear a strong family resemblance to 'loans by commercial banks [to customers] for current operations,' which are a member of the non-security family." Pet. App. 35a (citation omitted).[3]

Addressing the first *Reves* factor—the motivations of the parties—the court found:

> The uncontradicted motivation of the seller, Security Pacific, was to increase lines of credit available to Integrated as part of a continuing credit relationship. * * * Integrated's motivation was to have access to a source of short-term funds that was competitive with alternative short-term money market instruments to finance current operations or to cover a temporary cash shortage. The motivation of the participant * * * was to use its excess cash * * * [to] earn a fixed rate of interest that was higher than alternative money market instruments.

Pet. App. 35a-36a. Based on those findings, the court determined that "the overall motivation of the parties was the promotion of commercial purposes and not investments in a business enterprise." *Id.* at 36a. The court accordingly held that the first *Reves* factor indicated that the loan notes were not securities.

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[3] The Court in *Reves* included "notes evidencing loans by commercial banks for current operations" on the list of "instruments commonly denominated 'notes' that nonetheless fall without the 'security' category." 494 U.S. at 65. The other categories of non-security notes are: the note delivered in consumer financing; the note secured by a mortgage on a home; the short-term note secured by a lien on a small business or some of its assets; the note evidencing a character loan to a bank customer; short-term notes secured by an assignment of accounts receivable; and the note that formalizes an open-account debt incurred in the ordinary course of business. *Ibid.*

The court determined that the second *Reves* factor—the plan of distribution—pointed to the same conclusion. The court observed that "[t]he opportunity to purchase short-term participations was offered only to institutional and corporate entities" and that "[i]ndividuals were specifically excluded." Pet. App. 36a. It also observed that "[l]oan participations were not freely negotiable, but were transferable only with the prior written consent of Security Pacific." *Ibid.* Primarily for those reasons, the court determined that "[t]he plan of distribution was * * * a limited solicitation to sophisticated financial or commercial institutions and not to the general public." *Ibid.*

The court noted that application of the third *Reves* factor—"the reasonable expectation of the investing public"—was complicated by the fact that "the Supreme Court has not defined 'investing public.' " Pet. App. 37a. But the court found that, even if "investing public" was narrowly understood to refer not to the general public, but only to "institutions that would be targeted by Security Pacific," the third factor weighed against concluding that the loan notes were securities. *Ibid.* The court reasoned that the MPA signed by potential purchasers provided "notice" to any "reasonable sophisticated financial or commercial institution" that "the instruments are participations in loans and not investments in business enterprises." *Ibid.*

The court held that the fourth *Reves* factor—the existence of other factors such as a regulatory scheme that reduces the risk of the instrument at issue—favored a conclusion that the notes were not securities. The court found dispositive that, as a national bank, Security Pacific was subject to Circular 181 of the Office of the Comptroller of the Currency, which addresses the purchase of loan participations by national banks. Pet. App. 37a & n.5. That Circular, in the court's view, "makes

application of the federal securities laws unnecessary." *Id.* at 37a.[4]

3. a. A divided court of appeals affirmed. The majority, after restating the district court's reasoning, concluded:

> [U]nder the *Reves* family resemblance analysis, as properly applied by the district court, we hold that the loan participations in the instant case are analogous to the enumerated category of loans issued by banks for commercial purposes and therefore do not satisfy the statutory definition of 'notes' which are 'securities.'

Pet. App. 10a.

b. Judge Oakes dissented. Relying primarily on the brief *amicus curiae* filed by the Securities and Exchange Commission (SEC) at the Second Circuit's invitation, he concluded that "these so-called loan notes were purchased in investment transactions and are securities." Pet. App. 11a. That conclusion was based on his view that the loan notes sold by Security Pacific "differ[] from * * * traditional participations in several important respects." *Ibid.* Judge Oakes explained that "[t]he participants, rather than being commercial lenders who engage in traditional loan participations, were instead in many cases non-financial entities not acting as commercial lenders but making an investment, and even though there were some banks that purchased the so-called loan notes, they generally did so not through their lending

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[4] The district court also held that the loan notes sold by Security Pacific were not "investment contract[s]" within the meaning of the federal securities laws, Pet. App. 38a; see also 15 U.S.C. 77b(1); *SEC* v. *W.J. Howey Co.*, 328 U.S. 293 (1946), and that petitioners failed to establish that Security Pacific breached any common law duty of good faith and fair dealing, Pet. App. 39a-41a. The latter holding was affirmed on appeal, *id.* at 10a, and neither holding is at issue in this Court.

departments but through their investment and trading departments." *Ibid.* Judge Oakes found that "[t]hese participants were motivated not by the commercial purpose of operating a lending business in which participations are taken as an adjunct to direct lending operations, but were motivated by an investment purpose." *Ibid.* Judge Oakes observed that "[t]he promotional literature put out by Security Pacific advertised the so-called loan notes as competitive with commercial paper, a well-recognized security under the Securities Act." *Id.* at 11a-12a; see also *id.* at 14a.

In addition, Judge Oakes emphasized that the Security Pacific loan notes "differ from traditional loan participations in the scope of information available to the purchasers." Pet. App. 12a. Traditional loan participations, as Judge Oakes understood them, involved one-on-one negotiations between the lead lender and the participant, and the participant was able to "inspect all information, public and non-public, that is relevant, and consequently [was] able to do [its] own credit analysis." *Ibid.* In contrast, he determined, "Security Pacific did not provide the participants with non-public information it had * * *, and the purchasers were not in a position to approach the hundred or more possible borrowers in the program and conduct their own [credit] examinations." *Ibid.*

4. On petitioners' petition for rehearing and suggestion of rehearing en banc, which the SEC supported, the panel amended its opinion in two significant ways. Pet. App. 22a-23a. First, it emphasized that "[t]he plan of distribution specifically prohibited resales of the loan participations without the express written permission of Security Pacific." *Id.* at 22a. "This limitation," the panel explained, "worked to prevent the loan participations from being sold to the general public, thus limiting eligible buyers to those with the capacity to acquire information about the debtor." *Ibid.* Second, the panel emphasized the narrowness of its holding, stating: "We recognize that even if an underlying instrument is not a se-

curity, the manner in which participations in that instrument are used, pooled, or marketed might establish that such participations are securities." *Id.* at 23a.

Judge Oakes again dissented, stating that he continued to "think the [majority's] decision wrong." Pet. App. 23a. He recognized, however, that "the changes in the panel majority opinion do a lot to narrow the scope and, hence, the impact of its decision." *Ibid.*

DISCUSSION

We believe that the court of appeals' decision, holding that the loan notes sold by Security Pacific are not securities, is open to serious question. In our view, the court erred in the significance it attached to the fact that the notes were sold only to supposedly sophisticated institutions, and not individuals. The court also erred in concluding that the mere existence of banking guidelines for the purchase of loan participations weighs against the conclusion that loan participations are securities.

Despite those errors, we do not believe that further review is warranted. The Second Circuit correctly relied on this Court's recent decision in *Reves* v. *Ernst & Young*, 494 U.S. 56 (1990), to address the question presented here, and its resolution of that question does not conflict with the decision of any other court of appeals. Moreover, the other circuits have not had an opportunity to analyze loan note programs of the sort at issue here under *Reves*. Thus, although the issue whether such loan notes are securities might require this Court's consideration at some point, review is not required in this case.

1. There is no dispute in this Court that the court of appeals correctly relied upon *Reves* to decide whether the loan notes sold by Security Pacific were "securit[ies]." The only question is whether the court of appeals applied the four *Reves* factors correctly to conclude that the loan

notes bear a strong family resemblance to notes evidencing commercial bank loans, which the Court in *Reves* identified as a type of note that is not a security. We believe that the court of appeals' application of *Reves* was flawed.

a. For example, in applying the second *Reves* factor—which requires courts to "examine the 'plan of distribution' of the instrument * * * to determine whether it is an instrument in which there is 'common trading for speculation or investment,'" *Reves*, 494 U.S. at 66 (quoting *SEC* v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351, 353 (1943))—the court of appeals initially attached great significance to the fact that "only institutional and corporate entities were solicited," and not individuals. Pet. App. 9a. The court placed too much emphasis on the nature of the purchasers.

Both sophisticated and unsophisticated purchasers are protected by the antifraud provisions of the Securities Act. That is clear from the provisions in the Securities Act that exempt commercial paper from the statutory registration requirements. See 15 U.S.C. 77c(a)(3). Congress exempted commercial paper from registration because it was advised that the professional, institutional investors that purchased commercial paper did not need the protection afforded by registration. See H.R. Rep. No. 85, 73d Cong., 1st Sess. 15 (1933); *Federal Securities Act: Hearing on H.R. 4314 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 1st Sess. 179-183 (1933). By exempting commercial paper from the registration requirements, but not the antifraud provisions, Congress demonstrated that it knew how to limit the protections afforded by the securities laws to exclude sophisticated institutional actors. That Congress prescribed no such limits in the antifraud provisions shows that it did not intend to withhold the protection of those provisions from institutional investors. See *Securities Indus. Ass'n.* v. *Board of Governors*, 468 U.S. 137, 151

(1984) (Congress rejected proposed amendment to exclude commercial paper from antifraud provisions of the Securities Act.).

Rather than focusing exclusively on the nature of the purchasers, the court of appeals should have focused on the ability of purchasers to obtain and evaluate full credit information on the borrower. The court appeared to recognize as much when, in amending its opinion, it stated that the restriction on resale of the loan notes "limit[ed] eligible buyers to those with the capacity to acquire information about the debtor." Pet. App. 22a. We agree that a note purchaser's capacity to obtain credit information on the borrower, in order to be able to verify the representations made by the seller of the instrument, is an important factor in determining whether the note is a security.[5] An overriding purpose of the securities laws is to ensure that persons who purchase financial instruments are accurately informed about the risks of the purchase. See, *e.g.*, *Landreth Timber Co.* v. *Landreth*, 471 U.S. 681, 687-688 (1985). That purpose recognizes that even sophisticated institutional investors cannot make informed investment decisions without truthful information. Cf. *id.* at 692 (rejecting argument that antifraud provisions protect only "passive investors" and not the transfer of control of business to "entrepreneurs").

The court's amendment mitigates, but does not cure, the court's flawed application of the second *Reves* factor.

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[5] In the only decision to date applying the court of appeals' decision in this case, a district court held that commercial mortgages and mortgage participations purchased by unsophisticated members of the general public who lacked full access to credit information are not securities. See *Pollock* v. *Laidlaw Holdings, Inc.*, 90 Civ. 5788 (PKL) (S.D.N.Y. Jan. 21, 1993). That decision reflects a serious misreading of the opinion below, which, as discussed in the text, is premised on the Second Circuit's determination that purchasers had the capacity to obtain adequate information about the borrowers.

The court did not explain the basis for its determination that petitioners had the capacity to acquire information about Integrated. See Pet. App. 22a. And the record suggests that at least in some cases loan note purchasers did not have the opportunity to conduct a full credit review of the borrowers. See, *e.g.*, C.A. App. 772, 1036, 1375-1376, 1845-1850; but cf. Pet. App. 34a (district court found that purchasers were "personally in a position to watch and protect [their] investment"). Any factual error on that point, however, does not extend beyond the circumstances of this case.

b. The court also erred in applying the third *Reves* factor, which requires courts to "examine the reasonable expectations of the investing public." 494 U.S. at 66. The court focused solely on the MPAs, which it believed provided "ample notice that the instruments were participations in loans and not investments in a business enterprise." Pet. App. 9a. The court ignored the marketing material that Security Pacific provided to potential purchasers, which described the loan notes as "investments" comparable to commercial paper, a recognized security. See Pet. App. 13a, 14a (Oakes, C.J., dissenting); C.A. App. 54-56. That material was plainly relevant to determining whether the loan notes reasonably could be perceived as securities, and it should have been considered together with the language in the MPAs describing the notes as interests in "loans" (*id.* at 48). Cf. *C.M. Joiner Leasing Corp.*, 320 U.S. at 346.

Here again, however, the order amending the panel's original opinion goes some way toward correcting the court's error. In that order, the court expressly recognized that "the manner in which participations in [an] instrument are used, pooled, or *marketed* might establish that such participations are securities." Pet. App. 23a (emphasis added). Thus, even though the original Second Circuit decision failed to discuss the marketing material in this case, the amended decision does not preclude consideration of such material in future cases.

c. The fourth *Reves* factor requires a court to determine "whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary." 494 U.S. at 67. The court of appeals' opinion indicates that it misunderstood the fourth factor. The court stated that the fourth factor is satisfied by "the existence of another regulatory scheme." Pet. App. 10a. The court accordingly decided that the fourth factor weighed against concluding that the loan notes were securities, based solely upon the existence of the Office of the Comptroller of the Currency's Circular 181, which sets forth "policy guidelines on loan participations by national banks" (*id.* at 48a). *Id.* at 9a. The court thus apparently found the mere existence of Circular 181 dispositive; the court did not determine whether Circular 181 "significantly reduce[d] the risk" associated with the loan notes sold by Security Pacific, as it was required to do under *Reves*.

The decisions cited in *Reves* indicate that the fourth factor is satisfied only by a circumstance that substantially reduces the risk of the instrument at issue. See 494 U.S. at 69 (citing *Marine Bank* v. *Weaver*, 455 U.S. 551 (1982), and *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551 (1979)); see also *Uselton* v. *Commercial Lovelace Motor Freight, Inc.*, 940 F.2d 564, 582 (10th Cir.) (under *Reves*, risk-reducing factor must "essentially guarantee the individual's investment"), cert. denied, 112 S. Ct. 589 (1991). Circular 181 does not appear to meet that standard. It does not insure against monetary losses, as do the laws governing bank deposits, which were at issue in *Marine Bank*. See *Marine Bank*, 455 U.S. at 558. Nor does it define the substantive rights of loan participants in detail comparable to the detail with which the Employee Retirement Income Security Act of 1974, 29 U.S.C. 1001 *et seq.*, the statute at issue in *Daniel*, defines the rights of pension plan participants. See *Daniel*, 439 U.S. at 569-570.

Instead, Circular 181 sets out "controls over the risk associated with loan purchases or participations" that are "ordinarily" required to ensure that a national bank's purchase of a loan or a participation does not constitute an "unsafe or unsound banking practice" within the meaning of the Federal Reserve Act, 12 U.S.C. 1818. Pet. App. 50a. The controls are worded so as to afford discretion to bank regulators in evaluating a bank's purchases of loans or loan participations, as the term "ordinarily" indicates. Although the guidelines are addressed primarily to national banks that purchase loan participations, the Office of the Comptroller of the Currency construes the Circular to regulate sales activities by national banks such as Security Pacific by prescribing the permissible structure for sales of loan participations to both bank and non-bank purchasers. Still, the scope and effect of Circular 181 depends to a significant degree upon its administrative interpretation and application in particular situations. Consequently, it is difficult to conclude from the face of the Circular that it reduces the risk of loan participations to the extent, and with the degree of certainty, that appears to be required under the fourth *Reves* factor.

2. Although we believe that the Second Circuit's decision is flawed, we do not believe that further review is warranted.

a. This case concerns only the status of the loan notes sold by Security Pacific, not the entire loan participation market or even other types of loan note programs. Neither petitioners nor the SEC challenges the decisions holding that "traditional" loan participations are not securities. SEC C.A. Amicus Br. 4.[6] Instead, the SEC, like the

[6] The courts of appeals for six other circuits have held that loan participations are not securities. See *First Citizens Fed. Sav. & Loan Ass'n* v. *Worthen Bank & Trust Co., N.A.*, 919 F.2d 510, 515-516 (9th Cir. 1990) (applying Arizona law, which court considers to be identical to federal law); *McVay* v. *Western Plains Serv. Corp.*, 823 F.2d 1395, 1399 & n.4 (10th Cir. 1987); *Union Nat'l Bank* v. *Farmers Bank*, 786 F.2d 881, 884-885 (8th Cir. 1986);

petitioners, has taken the position—and continues to be of the view—that the Security Pacific loan notes were sufficiently distinct from traditional loan participations that those decisions do not apply, and that the loan notes were securities. SEC C.A. Amicus Br. 2-4; see also Pet. 6 ("Loan Notes Have Nothing To Do With Traditional Loan Participations"). Respondents, on the other side, argue that the decisions involving traditional loan participations govern this case. Br. in Opp. 8. Thus, this case presents an issue of first impression in the courts of appeals—*i.e.*, whether the particular type of instruments sold by Security Pacific are governed by the line of loan-participation cases cited above, or whether they are, instead, securities. There is no conflict among the circuits on that question, or on the status of loan participations

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Union Planters Nat'l Bank v. *Commercial Credit Business Loans, Inc.*, 651 F.2d 1174, 1179-1185 (6th Cir.), cert. denied, 454 U.S. 1124 (1981); *American Fletcher Mortgage Co.* v. *U.S. Steel Credit Corp.*, 635 F.2d 1247, 1253-1255 (7th Cir. 1980), cert. denied, 451 U.S. 911 (1981). The only court of appeals decision holding that loan participations are securities, *Lehigh Valley Trust Co.* v. *Central Nat'l Bank*, 409 F.2d 989, 991-993 (5th Cir. 1969), was repudiated by later decisions in that circuit, which have consistently held that traditional loan participations are not securities. See, *e.g.*, *United American Bank* v. *Gunter*, 620 F.2d 1108, 1115-1119 (5th Cir. 1980) (per curiam).

As to the district courts, an early decision in the Second Circuit held that a loan participation was a security, *Commercial Discount Corp.* v. *Lincoln First Commercial Corp.*, 445 F. Supp. 1263, 1267 (S.D.N.Y. 1978), and another held, in denying summary judgment, that the loan participation at issue might be a security. *NBI Mortgage Inv. Corp.* v. *Chemical Bank*, [1977-78] Fed. Sec. L. Rep. (CCH) ¶ 96,066 (S.D.N.Y. 1977), and *NBI Mortgage Inv. Corp.* v. *Chemical Bank*, [1976-77] Fed. Sec. L. Rep. (CCH) ¶ 95,632 (S.D. N.Y. 1976). More recent district court decisions, however, hold that loan participations are not securities. See, *e.g.*, *Developer's Mortgage Co.* v. *TransOhio Sav. Bank*, 706 F. Supp. 570, 573-590 (S.D. Ohio 1989); *Deauville Sav. & Loan Ass'n* v. *Westwood Sav. & Loan Ass'n*, 648 F. Supp. 513 (C.D. Cal. 1986); *Vorrius* v. *Harvey*, 570 F. Supp. 537, 539-541 (S.D.N.Y. 1983).

more generally. The absence of a circuit conflict weighs heavily against review.

b. Nor, on balance, do other factors warrant review by this Court at the present time despite the absence of a circuit conflict. Loan participations have come to play an important and positive role in commercial banking in the absence of regulation under the federal securities laws.[7] The federal bank regulatory agencies[8] have advised us that, in their experience, the "loan note" market has not to date manifested major problems that suggest a pressing need for further regulatory attention. Petitioners likewise do not identify any problems beyond the circumstances of this case that make it advisable for this Court to resolve the status of the sort of loan notes in-

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[7] Banks sell loan participations to enhance their liquidity, diversify their loan portfolios, and serve the credit needs of borrowers. See *McVay* v. *Western Plains Serv. Corp.*, 823 F.2d 1395, 1398 (10th Cir. 1987); Hutchins, *What Exactly Is a Loan Participation?*, 9 Rut.-Cam. L.J. 447, 449 (1978). When banks reach internal or legal lending limits, loan participations enable banks to continue providing borrowers needed credit. See Simpson, *Loan Participations: Pitfalls for Participants*, 31 Bus. Law. 1977, 1977 (1976). Moreover, certain accounting benefits flow from participating a loan. See Note, *Bank Loans As Securities: A Legal and Financial Economic Analysis of the Treatment of Marketable Bank Assets Under the Securities Acts*, 40 U.C.L.A. L. Rev. 799, 826 n.81 (1993). Over the last decade, loan participations have accounted for an increasingly large portion of the total bank credit extended to commercial and industrial enterprises. C.A. Amicus Br. of New York Clearinghouse Ass'n 1; G. Gorton & J. Haubrich, *The Loan Sales Market*, in 2 *Research in Financial Services: Private & Public Policy* 85, 95 (G. Kaufman ed. 1990). They are, furthermore, essential to the ability of commercial banks to compete with other financial services organizations for the business of commercial and industrial borrowers.

[8] The agencies are the Department of the Treasury, including the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation.

volved here in the absence of a conflict among the lower courts.

Moreover, we have been informed that in light of this case, the federal bank regulatory agencies are considering whether to provide further guidance to the banking industry on loan-participation programs, including guidance on the information that should be made available to purchasers of loan notes and other participations. That prospect also weighs against review. Further guidance by the bank regulatory agencies may reduce the potential for abuse in this market and may be regarded by the lower courts as relevant to the application of the *Reves* factors in future cases, thereby diminishing the importance of the question whether those factors were properly applied in the present case.

c. Changes in the legal and factual landscape could well make the question presented here suitable for review by this Court at some point. According to *amicus curiae* New York Clearing House Association (C.A. Br. 1), "the [loan note] business has grown substantially and has evolved toward shorter-term loans, sold more frequently than in the past to institutions other than banks." Accord Note, *Bank Loans As Securities, supra,* 40 U.C.L.A. L. Rev. at 825-828. In addition, according to recent commentary, "the loans sold today are increasingly obligations of noninvestment grade firms without access to the commercial paper market. * * * Consequently, relative to investment-grade participations, less public information is available to investors about the companies whose debt is being marketed." *Id.* at 827. Those developments have been accompanied by changes in the way loan participations are marketed. See *id.* at 828 & n.90.

These changes may well be relevant in determining the status of the notes under *Reves*, as the Second Circuit recognized. See Pet. App. 23a ("the manner in which participations * * * are used, pooled, or marketed might establish that such participations are securities"). The

changes may also further implicate the concerns of the SEC in ensuring that the protections of the securities laws are afforded to those purchasers of loan notes who do not have adequate access to credit information and who may not participate in the market in the manner of a lender that is in a position to make independent credit determinations. But the relevance of changes in the loan note market should be further explored in the first instance by the courts of appeals—as well as by the SEC and the bank regulatory agencies—rather than this Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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